



February 12<sup>th</sup>, 2016

*Note: numbers referenced are as of the close on February 11<sup>th</sup>. Given elevated levels of volatility any references we make to what the market is doing may be outdated by the time we finish writing the sentence.*

January was a very trying month for investors. Unfortunately the Dark Horse was not immune. The fund had a poor showing to start 2016, as we were unable to display the modest downside capture that has been our hallmark over the past few years.

The month started miserably for the equity markets. Three weeks in and the S&P/TSX had plunged nearly 12%. At that point, the Dark Horse was down around 1.5%. The fund was acting as it should. Our low net exposure was limiting our losses to an acceptable amount. Suddenly, everything changed. Oil, the loonie and every liquid Canadian stock that had been trounced rocketed higher. They bounced with even more ferocity than they had previously cratered with. In just over a week, the TSX recaptured most of its losses, ending the month down a shockingly nondescript 1.4%. The S&P 500 also enjoyed a rally at month-end, albeit a much more muted one. That index ended January down 5.1%.

What didn't bounce was anything that we owned. The securities that comprise our long book fell in sympathy with the crushing start to the month but sat around like a bunch of slack-jawed idiots doing nothing as the market gunned higher. This was despite the fact that there was some material, tangible good news from a few of our holdings (more on this later in the letter). It simply did not matter. Fund flows and algorithms were driving the moves in the market – first lower and then higher. Individual stories appeared entirely irrelevant. All this combined to bring our fund down more than 250bps as the Canadian market rallied nearly 1,000 bps. This monumental crapitude happened over just seven trading days.

This is not an altogether new dynamic for us. We have seen it play out before, although we can't recall it occurring over such a compressed timeframe. Back in 2011, during the mini-crisis over the S&P downgrade of the United States credit rating, our long book plunged with the market (we were admittedly far too net long back then). When the major indices rallied back we got nothing but crickets from our book. Eventually investors got around to finding value where we saw it and our long book started to catch up.

Our short book, being typically more exposed to beta, will move in lockstep with the market (or even in an exaggerated fashion). This can, at times of rapid market ascents, exacerbate the disconnect between our fund and the performance of the overall equity markets. Another similarity between this past month and August of 2011 is that in both instances we were caught offside by unique pockets of strength in the Canadian market which further worked against our index shorts. In 2011 it was the performance of gold and gold equities that allowed the Canadian equity market to vastly outperform its global peers. In late January it was the sudden spike in energy stocks that propped up the Canadian indices and further weighed on the fund.

February looks much like the beginning of January with oil having given up much of its recent gains and equities retreating. Thankfully, the Dark Horse is back to performing as it should with the fund being essentially flat month to date versus 500bps ballpark losses for both Canadian and U.S. markets.

Simply put, the markets are currently in the throes of panicky chaos. When we say markets we are referring to most every constituent of the global capital markets. Equities, fixed income, currencies, commodities and pretty much anything else you can think of are in the midst of turmoil, the likes of which haven't been seen since 2008. \$20 oil is a possibility but so is \$50 oil. Very little can be ruled out during this time of such exceptional volatility. Stateside, the New Hampshire primaries were just won by an avowed Socialist and the Norovirus incarnate. Clearly anything is possible, except perhaps rationality.

Over the past 25 trading days for the S&P/TSX Composite Index how many days do you guess registered a less than 1% move from the previous day's close? The answer is *six*. On only two of those days the market didn't rise or fall at least 1% at some point during the day. How much turbulence can a plane sustain in mid-air before it breaks apart? We have no idea, but whatever it is, this may be the capital markets equivalent.

Such absurd volatility certainly creates a difficult investing environment. While intellectually we all know that ultimately opportunities are presented by this chaos, the pain inflicted in the interim cannot be dismissed. The age old axiom of "buy when there is blood in the streets" will always hold some truth but also serves as a reminder that these wonderful bargains come at a bruising cost to someone.

In January we took a couple nicks and a small amount of our blood was shed. Thankfully we have a solid track record, committed investors and the fund does not use leverage. As such, we will be afforded the luxury of time as we wade through this muck. Others will not be so lucky. We do not believe that the impact of the crushing losses suffered by many market participants, be they small-cap Canadian investors or sovereign wealth funds, has fully run its course. As such, we remain cautious despite the ever expanding ranks of the 52-week low lists.

We mentioned earlier that tangible good news from some of our holdings had fallen completely on deaf ears in the midst of all this bedlam. The specifics of this claim make up this month's essay portion of the letter.

#### **If a Tree Falls at Forestar, does it make a sound?**

Forestar has been a huge disappointment to us and likely anyone else who has invested in it. We appreciate that given the company's track record there is a high hurdle for this company to garner positive attention. That shouldn't mean, however, that the stock can literally *never* go up regardless of what happens. Sadly for long-suffering shareholders this appears to be the world we are now in. Case in point, this past Monday Forestar made two major, positive announcements<sup>1</sup>. Firstly, the company will be adding two new activist shareholder representatives to the Board. Having two additional experienced and properly incented voices around the Board table surely can't be a bad thing. Secondly, the company announced that it had reached a deal to divest its non-core hotel property, The Radisson Hotel & Suites-Austin Downtown, for \$130 million....you read that correctly, \$315 thousand a room for a Radisson.

We believed the company would get substantially more than the \$34 million the hotel was on the books for, given its prime location and the health of the Austin market, but even our most optimistic scenario fell short of \$130 million. In its current depressed state, \$130 million represents nearly half of

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<sup>1</sup> The second announcement, the hotel sale, was surprisingly not press released. Instead the information was disclosed via an 8-K with the Securities and Exchange Commission.

Forestar's market cap. We were also uncertain that a deal could be consummating this quickly given a mostly dead market for hotel M&A. The Board and management of Forestar deserve full marks for executing on this divestiture. The market essentially gave the company a "C-", bidding the stock up a measly 2% the day of the announcement – a pittance it has since given back.

There was a time when such material news would be properly and immediately reflected in the trading value of Forestar's stock. That is, in fact, the very definition of an efficient market. Unfortunately efficiency is hard to come by currently, particularly when it comes to the more nuanced and lesser known securities that we typically invest in. Case in point 2: Rand Capital Corp.

Even for us, Rand is at the extreme edge of obscurity in terms of what we get involved with. In fact there is no way we would have even known about the company had we not been looking to fill some downtime in our schedule while in downtown Buffalo a few years ago. While there is a great deal of rigor and process involved in our investment approach, the method in which companies arrive on our radar can, at times, be absolutely random. Rand is a clear example of this.

In early January, Rand announced that it had reached a deal to sell its largest investment, Gemcor, for \$14 million. At the time of the announcement, Rand had a market cap of just \$23 million. The proceeds from Gemcor when combined with cash on the balance sheet accounted for approximately \$3 a share. Before the Gemcor announcement, the stock last traded at \$3.70. It was not previously disclosed that Gemcor was for sale and the \$14 million was a 40% premium to the book value of the investment. This was clearly incremental positive news. Fast forward a couple weeks and the stock is....\$3.70.

Rand, being so small, is certainly not a name followed by many investors or analysts. That being said, in a functioning market the stock has historically reacted to tangible pieces of data – not necessarily immediately, but within a reasonable timeframe. The precedent was November of 2014 when the company announced one of its largest holdings, Binoptics, was being acquired for \$9.2 million. Two weeks later the stock had appreciated 22% and had increased by one-third a month after the sale.

The ignorance and indifference towards such material developments is frustrating, but should not be a permanent condition assuming normalcy one day returns to the equity markets. This is particularly certain with companies like Forestar and Rand that we do not view as going concerns. Less tangible pieces of news like an earnings beat or a new customer win can be ignored and never translate into higher equity values. Whatever perceived gains in earnings and cash flows are negated by lower multiples that a troubled market will apply to those metrics.

Conversely, if a company is all but putting itself into run-off and converting assets to cash, the value of that cash is simply too hard to ignore. It is those types of *un-ignorable* catalysts that are needed to move lesser known stocks in unaccommodating markets. It is also the potential for such *un-ignorable* catalysts that we will continue to seek out in the absence of a more constructive view on the overall market.

Until next month,

Anthony Hammill

Lee Matheson

| Series                                | Dec 31, 2015 | Jan 31, 2016 | Monthly Return | YTD Return | Annualized Return Since Inception (April 3, 2009) |
|---------------------------------------|--------------|--------------|----------------|------------|---|
| <b>Master – Class A</b>               | \$240.5490   | \$230.1350   | -4.33%         | -4.33%     | 13.0%   |
| <b>Series 5 - June 2015 – Class A</b> | \$240.2997   | \$229.8964   | -4.33%         | -4.33%     |   |

*\*From inception return used for series launched during the year*

*All numbers reported after fees and expenses. See subscription confirmations for your Series.*

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## **About Broadview Capital Management Inc. and the Broadview Dark Horse LP:**

Broadview is the manager of the Broadview Dark Horse LP (“The Dark Horse”), a fundamental-based long/short investment partnership. Broadview utilizes its relatively small size, contrarian nature and willingness to perform extensive due diligence to deliver strong risk-adjusted returns for its investors. The managers concentrate on going where others can’t or won’t to find investment opportunities.

The firm is run with the philosophy that it will manage “as much money as it deserves to manage” and that a dedication to working hard for existing clients is the best way to grow the business in a sustainable fashion. It is not Broadview’s intention to take on additional investment mandates for the foreseeable future beyond the Dark Horse LP. Broadview was founded in October of 2008 and the Dark Horse was launched in April of 2009.

### **CONTACTS:**

**Anthony Hammill, CFA**

(416) 406-4808 or [anthony@broadviewcapital.ca](mailto:anthony@broadviewcapital.ca)

**Lee Matheson, CFA**

(416) 406-4800 or [lee@broadviewcapital.ca](mailto:lee@broadviewcapital.ca)

**Jason Bernstein**

(416) 406-4802 or [jason@broadviewcapital.ca](mailto:jason@broadviewcapital.ca)

**Broadview Capital Management Inc.**

181 Carlaw, Suite 302

Toronto, Ontario M4M 2S1

[www.broadviewcapital.ca](http://www.broadviewcapital.ca)

